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C O N F I D E N T I A L SECTION 01 OF 02 SOFIA 000485

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SUBJECT: BULGARIA BRACES FOR EU REPORT

REF: SOFIA 0365

Classified By: CDA Alex Karagiannis for reasons 1.5 (b) and (d).

11. (C) Summary: Bulgaria is bracing for a harshly worded EU monitoring report, to be released in Brussels on July 23. Our contacts tell us the draft report fails Bulgaria on all six benchmarks in the areas of judicial reform and the fight against corruption and organized crime. They say the report extends the monitoring mechanism past its original 2010 mandate, but does not recommend the harshest sanctions available to the EU: the non-recognition of Bulgarian court decisions or the suspension of Bulgaria's voting rights in the European Council. Instead, the EU has apparently decided to hit Bulgaria in the pocketbook. A separate report on the Bulgarian administration of EU funds will recommend withholding up to USD 1 billion in EU pre-accession funds. After the draft report on Bulgaria's mishandling of EU money and a separate, scathing draft report by the European Anti-fraud Office (OLAF) were leaked to major media outlets on July 17 and 18, the Bulgarian opposition revived its call for a vote of no confidence against the Socialist-led government. It also demanded the resignation of President Parvanov over his alleged dealings with a central figure in one EU funds scandal. While neither initiative is likely to succeed, our high-level GOB contacts predict the EU reports will trigger cabinet changes. For the first time, they are credibly speculating that this government will not last the final year of its mandate. End Summary.

WHAT IS EXPECTED

12. (C) Our EU Commission contacts confirm the long-awaited monitoring report on Bulgaria will come out in three parts: a technical monitoring report, a political assessment of Bulgaria's progress, and a separate paper on Bulgaria's handling of EU funds, a draft of which was leaked to media outlets July 18. They say privately that the report is the harshest the Commission has ever issued on a member state, but they also warn that all three reports are subject to revision -- and may be softened -- before the European Council votes on them just prior to their release July 23. An adviser to the Prime Minister told Charge July 17 that the technical and EU funds reports fail Bulgaria on all six judicial reform benchmarks, although the GOB believes it has fully met the requirements of one benchmark and partially fulfilled the requirements of a second. The adviser, who viewed a draft of the EU report, says the report extends the monitoring mechanism past its 2010 mandate but does call for the non-recognition of Bulgarian courts decisions or suspension of Bulgaria's European Council voting rights.

13. (C) The EU funds report cites "critical weaknesses" in

administrative and judicial capacity, high level organized corruption and organized crime, fraud and conflicts of interest as barriers to the effective absorption of EU funds in Bulgaria. The draft report suspends permission for two authorizing agencies under the Ministries of Finance and Regional Development to administer EU funds. It also extends the previously announced suspension of pre-accession funds under the PHARE, SAPARD (agriculture) and ISPA (infrastructure) programs. With this report the Commission announces the freezing of disbursements and reimbursements of a number of structural funds and post-accession funding mechanisms (for fisheries, administrative capacity, migration flows, and the Schengen Facility) until Bulgaria improves its ability to administer such funds. In all, Bulgaria may forfeit up to USD 1 billion in pre-accession and initial post-accession funds.

THE LIKELY FALL-OUT

14. (C) Our contacts anticipate significant political fall-out from the EU Reports. The ruling coalition plans a coalition council meeting on July 26 to discuss ways to address the report's findings. Cabinet changes could result, with Minister of Regional Development Asen Gagauzov the most likely victim given his ministry's mishandling of pre-accession funding. The opposition has announced a no-confidence motion against the government on July 24. The motion, the sixth against PM Stanishev's cabinet since it took office in August 2005, is likely to fail, especially

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given early indications that coalition partner NMS will stand behind the government. The opposition has also called for the resignation of President Parvanov, given his alleged ties with Lyudmil Stoikov, a central figure in a European Anti-Fraud Office (OLAF) investigation, but this effort is also doomed to fail. While Stanishev's cabinet will likely emerge nearly intact after the EU Report, it will be weakened. Our high level contacts are now openly predicting this government may not serve out its June 2009 mandate. In its battered state, they reckon, it may well crumble under the intense pressure of the budget season, which will begin in early fall. The opposition parties, though they smell blood, are not themselves ready for early elections, so much maneuvering and political posturing will ensue. The Prime Minister is no defeatist and he is intent on pushing forward, both on broad reforms and attracting more foreign investment no matter the partisan turbulence.

COMMENT

15. (C) If it is not overly softened on the political level in the coming days, the EU monitoring report on Bulgaria should deliver a needed jolt to the government on fraud, corruption and organized crime. We should continue to reinforce the report's message on the need for greater transparency, but at the same time acknowledge the efforts Bulgaria has made in the past several months. It created the new Agency on National Security (DANS), closed the duty free shops, appointed the highly-respected Meglena Pluchieva as Deputy Minister in Charge of EU Funds and empowered her to implement a far-reaching action plan to answer concerns on the administration of those funds. These successes are the direct result of the hard work of a handful of Bulgarians who, despite operating in a tremendously difficult environment, are convinced of the need for reform. Our view -- which will be sought out in the coming days -- should acknowledge their efforts but underscore the need to do more.

Karagiannis